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From: Audit Clerk

Date

The Difference between the Responsibility of Management, those Charged with Governance and the Auditor concerning the Prevention and Detection of Fraud

The management has the primary responsibility of preventing and detecting fraud, thereby limiting the auditor's ability to obtain audit evidence on fraud. The management responsibility for detecting misstatements means that they must detect and prevent fraud. These internal controls must be reinforced by the board of directors through its audit committee. On the other hand, the role of the external auditors is to provide the board of directors with reasonable assurance on whether the financial statements if the company is presented truly and fairly, in all material respect. The auditor also plays the role of providing a reasonable assurance that the financial statements have been prepared per all the legislation and regulations that govern the financial reporting framework with the jurisdiction where the business operates.

However, the auditor is obliged to be aware of the possibility of management responsibility to prevent and detect fraud overriding the internal controls and audit procedure that is meant to detect the errors. While the auditor may detect fraud during the audit process, such is not the responsibility of the auditor because an audit is not an official investigation of any wrongdoing in an entity. Therefore it is not the responsibility of the auditor to assure that the financial statements are free from fraud and errors that may cause misstatement. The limitation of audit engagement makes the audit evident persuasive and not conclusive

The Societal Misconception over the Role of the Auditor concerning the Prevention and Detection of Fraud in an Audit of Financial Statements

The misconception that exits in the society over the role of auditors in respect to prevention and detection of fraud during an external audit of financial statements is attributed to the inaccurate media report combined with the corporate failure to publicize the role of auditors. The overwhelming debt on the quality of the audit report is also to blame for the widespread misconception of the role of auditors to detect and prevent fraud in their engagement. This misconception is an expectation gap because it creates a discrepancy between the actual role of the audit and the societal expectation of what the audit ought to do or should do.

The first misconception is that the primary objective of an audit is to detect fraud. This misconception is contrary to the ISA ASA 240 which places the responsibility of preventing and detecting fraud in the financial statements on the board of directors and the management. With this clarification, it is evident that the auditors are left with the responsibility of maintaining a professional skepticism during the audit engagement. The auditor thus plays the role of having a questioning mind attitude and remaining alert to any condition that could portray the possibility of material misstatement in the financial statements. Therefore, the auditor only plays the role of identifying the possibility of fraud and error which should be used as a critical assessment for evidence of any immaterial statement.

The other misconception is that the auditor has a role of examining all, or most, business transactions to be able to ascertain that the financial statements are correct. The third misconception is that the audit of the financial statements is an activity that relieves management the responsibilities of preparing and presenting the accurate financial statements free of misstatements, errors, and frauds. The fourth misconception that the auditors should conduct an audit in compliance with the Accounting Standards of South Africa.

It is imperative to note that the trust and public confidence in the relevance and quality of the audit reports have fallen due to the expectation gap that keeps on increasing. The expectation of an infallible audit makes the society to expect the audit report to guarantee the directors that the financial statements are free from any fraud and misstatement notwithstanding the immaterial nature of the financial statements. Therefore, it should be understood that the management is fully accountable to the shareholders to ensure that there is a reliable and effective internal control coupled with a culture of ethical behavior and honesty in reporting the financial statements.

Three Reasons why an Auditor presumes that there are Potential Risks of Fraud Relating to Revenue Recognition in Entities

While ASA 315, places the responsibility of identifying and assess the risks of material misstatement resulting from fraud at the financial report and assertion level for different classes of transactions, disclosure, and account balances on auditors, there are potential risks of fraud relating to the recognition of revenues in entities. The auditor must, therefore, presume that there exist risks of fraud in revenue recognition, that there is a need to evaluate the types of revenue that breathe risks, and that such risks could be attributed to revenue transactions or assertions.

These three presumptions obligate the auditor to document and conclude that the three presumptions are not applicable in the circumstances of the professional audit engagement. The auditor must also presume that the audit engagement identified revenue recognition as a risk of material misstatement arising from fraud. (Ref: Para. A28-A30) 27. It is also a requirement that the auditor treats the assessed risks potential risks of fraud of material misstatement attributed to revenue recognition as significant risks to the extent not already done. Ostensibly, the auditor is required to obtain an understanding of the internal controls activities inherent to such risks. (Ref: Para. A31-A32).

The auditor must also presume that the material misstatement due to fraudulent financial reporting on revenue recognition may be as a result of overstatement or understatement of revenues. Such risks vary between different entities due to the pressures and incentive that prompt the management to commit fraudulent financial reporting to meet the performance measure based on the entities revenue growth or profit. There are cases where the members of the public may rebut the existence of risks of fraud in revenue recognition prompting the auditor to conclude that there is no risk of material misstatement due to fraud out of revenue recognition for cases of a single type of simple revenue transaction.

2 Examples of Cases of Revenue Misstatements that have been Reported in the Media

There are many cases of revenue misstatement that have been reported in the media in the recent past. These reports indicate the extent to which publicly listed companies can go to give misleading information about their financial performance. The first case was reported by fortune news media over the misstatement of financial statements by technology firm such as Uber and Lyft as a way of gaining entry into the Wall Street stock market. The journey of these two technology firms towards their IPO has proved that indeed they had engaged in a misstatement. When the two firms continued to suffer loses and questions on when they would begin to be profitable emerged, they started misstating their financial reports to earn investor confidence and pursue their growth objectives (Mashayekhi, 2019). The misleading prospectus or Lyft during the IPO saw it overvalued at $24billion with shares trading at $72. The misstatements include misrepresentation of share in North America and failure to account for the return of over 1,000 electric bicycles.

The second case of revenue misstatement is the case of Jumia that is accused of revenue misstatement which was disappointing to investors after they realized that the revenues report include fraudulently misstated orders. Jumia engaged in such misstatement to portray that its revenue increased to 58% yet the sale had fallen by € 1.27 million below the investors' expectations (Egenuka, 2019). There is no doubt that such allegation will prove bumpy for Jumia as it struggles to penetrate the African e-commerce market.

References

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